



March 12, 2004

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington D.C. 20551

Re: Availability of Funds and Collection of Checks  
Docket number R-1176

Dear Ms. Johnson:

Commercial Federal Bank (CFB) welcomes the opportunity to comment on the Federal Reserve Board's proposed rule to implement the Check Clearing for the 21<sup>st</sup> Century Act (Check 21). CFB, headquartered in Omaha, Nebraska is a federally chartered thrift with 12 billion in assets and 193 locations in Nebraska, Iowa, Colorado, Missouri, Kansas, Oklahoma and Arizona.

### **CFB's Position**

CFB supports efforts to increase the efficiency of the nation's payments system while minimizing the effect of unexpected disruptions to air and ground transportation systems. We generally support the Federal Reserve's proposed regulations and commentary that would implement Check 21. We have several suggestions that would further facilitate check truncation and reduce regulatory burden. We specifically offer comments on the following issues:

- Shortening the model consumer education disclosures.
- Allowing institutions to provide consumer education disclosures when a customer receives a substitute check after requesting a copy of an original.
- Implementing a Public Awareness Campaign.
- Clarifying how the MICR line should be treated on the substitute check vs. the original check in relation to their legal equivalence.

**Customer Education Disclosures.** Section 12 of the Check 21 Act requires institutions to provide consumer awareness disclosures that explain substitute checks and substitute check rights. The Federal Reserve has proposed model language to help institutions comply with this requirement. Institutions are not required to use the model language; however, those that do will be protected under the Act's safe harbor, provided that the information in the disclosure accurately describes the bank's policies and practices.

Model language. We believe that the Federal Reserve has succeeded in creating a model notice that is clear and easily understood. However, it is too long. We believe it is important to craft the most concise document possible even though institutions are permitted to rearrange or delete elements of the model language that are not required by statute. The Act's consumer awareness provisions are designed to help consumers understand how they will be affected by changes in check processing. To accomplish this goal, the model notice should be as brief as possible to minimize the likelihood that it will be tossed aside as one more piece of unnecessary paper.

Today's consumers are unlikely to read a lengthy disclosure on check truncation because they are already inundated with spam, junk mail, and other required disclosures. The importance of developing a concise model disclosure is further underscored by the fact that most community banks will elect to use the model language in order to take advantage of the Act's safe harbor.

Check 21 does not require consumer education disclosures to discuss the detailed rules governing expedited recredit. Instead, it requires a "brief notice" that explains legal equivalence and consumer rights. We request the Federal Reserve to generalize the expedited recredit sections of the model disclosure to only include the following points:

- Customers incurring a loss associated with a substitute check should contact the financial institution.
- Federal law provides customers with a right to an expedited recredit (up to \$2,500 within 10 days and the remainder no later than 45 days) if a customer incurs a loss due to the receipt of a substitute check instead of an original check.
- An institution may reverse a recredit after it investigates a claim and determines that the substitute check was properly charged to the customer's account.

If the Federal Reserve does not streamline the expedited recredit explanation, we suggest adding the phrase "mailed or delivered" to the disclosure section labeled "How to Make a Claim for an Expedited Refund." With this revision, sentence (1) would match the verbiage in section 229.54(b)(1) and would read "the date that we mailed or delivered the account statement showing the charge that you are disputing."

Delivery of Disclosures. Check 21 requires institutions to provide substitute check disclosures to consumers that request a copy of a check but receive a substitute check

instead.<sup>4</sup> The Act requires institutions to provide the disclosure at the time the request is made; however, the Federal Reserve has proposed two alternative rules governing when these disclosures must be provided and requests comment on which alternative is preferable. Alternative 1 would require a bank to provide the disclosure at the time of the request. Alternative 2 would require the disclosure to be made at the time the bank provides the substitute check to the customer.

CFB strongly urges the Board to adopt Alternative 2 because providing the mandatory disclosures at the time of the request is not realistic in the context of the day to day operations of a community bank. We also recommend that the Board interpret the phrase “at the time of the request” to allow institutions to provide the notice at any time after the request, up to and including the time the substitute check is delivered to the consumer.

We believe that this would be the most practical approach for a number of reasons. First, allowing institutions to provide the disclosure when the substitute check is provided will allow institutions to more carefully monitor compliance. A wide range of bank employees, including tellers, customer service representatives, receptionists, operators, or even branch managers may take a customer’s request for a copy of a check. Ensuring that all of these individuals provide the requisite disclosure at the time the request is made would be a compliance nightmare. Alternative 2 minimizes this problem by enabling institutions to limit the number of personnel tasked with compliance. Second, an institution may not know at the time of the request whether it will provide a copy of the original check or a substitute check. Consequently, requiring disclosures at the time of the request may result in the consumer receiving a disclosure describing rights that may not apply to the item that the customer ultimately receives. Finally, this approach would avoid the possibility of two separate mailings in the event that a check is requested via telephone.

**Other Consumer Notices.** In addition to distributing customer education disclosures about substitute checks, institutions are also required to notify customers when:

- Their account has been recredited;
- An expedited recredit claim has been denied; and when
- An amount previously recredited has been reversed.

The proposed rule includes clear and concise model notices that are designed to help institutions satisfy these disclosure requirements and clarify regulatory expectations. To make the model notices even more useful, we suggest that the Federal Reserve create a safe harbor whereby institutions using the models will be deemed to be in compliance with the notice requirements, provided they are given in a timely manner.

**Public Awareness Campaign.** Community banks will strive to make the transition to substitute checks as smooth as possible for their customers and will work to explain how customers are affected by changes in the check processing system. To augment these efforts, CFB strongly urges the Federal Reserve to institute a public awareness campaign similar to the one used to introduce the new \$20 note. Not only should the Federal

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<sup>4</sup> § 12(b)(4).

Reserve target the general public, education efforts should be extended to include local law enforcement agencies. We are concerned that prosecutors and law enforcement officials will be reluctant to accept a substitute check's legal equivalence, particularly when prosecuting fraud cases.

**MICR Issues.** We believe that portions of the proposed rule governing a substitute check's MICR line will create uncertainty as to how substitute checks should be handled. As a general matter, we believe that institutions should be encouraged to treat substitute checks just like original paper checks.

The Check 21 Act was not intended to change item processing operations; substitute checks were designed to be processed just like paper checks. Today, all institutions in the payment stream may make MICR line corrections as necessary. We strongly urge the Board to interpret the Act in a manner that permits institutions to correct substitute check MICR lines just like paper checks are corrected today. Any other interpretation will inhibit the utility of substitute checks and will bog down the payments system.

Legal Equivalence and Purported Substitute Checks. To meet the statutory requirements for a substitute check, an institution must print all of the MICR information from the original check on a substitute check that it creates, regardless of whether the MICR line on the original was properly encoded by a prior bank. If the MICR lines do not match, the item will not be the legal equivalent of the original check and the reconverting bank will have breached one of the substitute check warranties. Under the proposed rule, a substitute check that does not meet the MICR line requirement will not qualify for legal equivalence, but it will be subject to the Act's warranty, indemnity, and expedited recredit provisions. This is known as the purported substitute check provision.

We do not understand this approach. If an item does not meet the definition of a substitute check, how can it be subject to the substitute check warranties?

This approach is problematic in two instances:

1. Where the reconverting bank knows that there is an error in the MICR line of the substitute check. In this situation, the proposal would preclude a reconverting bank from correcting a MICR read errors on original checks; and
2. Where a reconverting bank creates a substitute check that does not mirror the MICR line of the original check. In this situation, other collecting and paying banks that receive such an item may not know that they have received an item that is not legally equivalent to the original check. If the collecting or paying bank does recognize that the item contains a MICR error, it would, as a practical matter, have to return that substitute check to the reconverting bank because the paying bank would have no authority to charge its customer's account.

For parties down the collection chain, the status of a substitute check as the legal equivalent of the original check should not be dependent on whether the MICR line is properly read from the original check. Further, reconverting banks should not be discouraged from correcting MICR errors on the original check.

We strongly urge the Federal Reserve to clarify that even if the MICR line on the substitute check does not accurately represent the MICR line on the original check, the substitute check will still qualify as the legal equivalent of the original check, provided that the reconverting bank places a MICR line on the substitute check in MICR ink. Under this approach, the amount field, the routing and transit fields, or any other fields could vary from the original check. The Act's warranty and indemnification provisions would protect any banks or consumers that receive a substitute check with incorrect MICR information.

This interpretation would allow institutions to treat substitute checks like paper checks. Reconverting banks would not be precluded from correcting MICR read errors on original checks, nor would collecting or paying banks down the collection chain have doubts about the status of substitute checks that they receive.

We also urge the Federal Reserve to 1) delete the purported substitute check provision from the final rule and 2) clarify that items that are subject to the warranty, indemnification, and expedited recredit provisions qualify for legal equivalence. Alternatively, if a purported substitute check does not receive the benefit of legal equivalence, then it should not be subject to the Act's warranty, indemnification, and expedited recredit provisions.

Repair of Substitute Check by Collecting/Paying Bank. The proposed rule would allow collecting and paying banks to repair a substitute check that was created from an original check that contained an error in the amount field. The rule does not discuss other situations in which a paying or collecting bank may repair the MICR line of a substitute check.

As a general matter, we believe that any rules governing the repair of substitute checks should encourage banks to treat substitute checks in the same manner as original paper checks. Accordingly, ACB strongly urges the Federal Reserve to allow, but not require, collecting and paying banks to repair any portion of the MICR line on a substitute check without compromising the item's legal equivalence. This approach would allow collecting and paying banks to repair MICR on substitute checks under the same rules that govern the repair of paper checks.

Prohibiting collecting and paying banks from engaging in MICR repair would not be consistent with the Act's goal of facilitating check truncation. Instead, it would dramatically slow check processing.

Non-MICR Ink. We also request that the Federal Reserve allow paying banks to provide substitute checks that are not printed in MICR ink to their customers, provided that all of the other requirements for substitute checks have been met. There is no need to print in MICR ink substitute checks that have been paid and cancelled. These items will not be used for forward collection or return, nor will consumers be able to know whether a check is encoded in MICR ink. It is less expensive to print a non-MICR substitute check,

and we do not believe that paying banks should be required to incur the cost of using MICR ink to create this class of substitute checks.

## **Conclusion**

In summary, we would like to reiterate our view that substitute checks should be treated in the same manner as paper checks. Imposing special substitute check MICR line and requirements would make check processing less efficient and would not carry out the Act's purpose of facilitating check truncation.

We congratulate the Federal Reserve on developing a set of model notices and disclosures that are easy to read and understand. To maximize the utility of the model language, we encourage the Federal Reserve to make the consumer education disclosure as concise as possible. We also ask the Board to give particular consideration to allowing institutions to provide these consumer education disclosures after a customer requests a copy of a check and receives a substitute check instead.

Thank you for the opportunity to comment on this important matter. Please contact the undersigned at 402-554-9296 or via email at [GaryFillman@CommercialFed.com](mailto:GaryFillman@CommercialFed.com) should you have any questions.

Sincerely,

Gary R Fillman  
Compliance Manager  
Commercial Federal Bank